United States Court of Appeals

for the Second Circuit

APPENDIX

74-1244 B

P/S

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

ANTOINETTE M. BRAGALINI, ARNOLD DAMSKY, WILLIAM WEINSTOCK, CARL ROGERS and ROSE ROGERS, H. L. FEDERMAN & CO., INC., SUZANNE MASTERS, STEPHEN MASTERS and NORMAN KEMPER, individually, and as Stockholders of MASTERS, INC., suing in behalf of themselves and for the benefit of said corporation and for the class of all other stockholders of said corporation similarly situated,

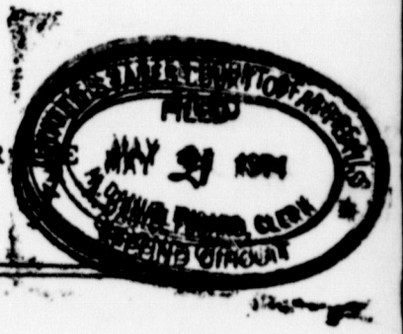
Plaintiffs-Appellants,

-against-

LOUIS BIBLOWITZ, MAX BIBLOWIT, JOSHUA BIBLOWITZ, RALPH J. WEINER, JOEL BIBLOWITZ, ARNOLD GINSBURG, HERBERT ABRAMSON, HARRY GRUNTHER, HARRY L. LEWIS, PINCUS PETERSEIL and MASTERS, INC.,

Defendants-Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK



APPENDIX - VOLUME I

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Relevant Docket Entries

Date	Filings - Proceedings
1967	
Dec. 20	Filed complaint and issued summons
1969	
Jan. 24	Filed Opinion #35552 - motion by the defts. pursuant to Rule 12b of the FRCP to dismiss the instant complaint for lack of subject matter jurisdiction and failure to state a claim upon which relief can be granted. is denied, as indicated, etc. For the reasons stated above defts. motion to dismiss the amended complaint, is denied. Settle order - Cannella, J.
Mar. 6	Filed Notice of Settlement and Order -- The defts. motion to dismiss and for a more definite statement is denied in all respects. This action is determined to be a class action within the provisions of Rule 23 and that the members of said class are all of the holders of common stock of Masters, Inc. on January 26, 1967 except Lady Rose Stores, Inc. etc. as indicated. -- Canella, J.
May 22	Filed defts. Answer Louis Biblowitz, et al
Dec. 16	Filed Opinion #36,387. Amended order and amended notice-- In reviewing the foregoing decision, this court is persuaded that the class action herein should proceed under sub.section (b) (3) of Rule 23. The notice adopted by the court is amended as indicated and the deft. Masters, Inc. is instructed to mail the amended notice as set forth in the amended order, both of which are appended to this opinion. So Ordered -- Cannella, J.
1971	
July 14	Filed ORDER granting deft Herbert Kurtz motion for summary judgment & finding that there is no just cause for delay that final judgment be entered in said deft's favor dismissing action as against Herbert Kurtz without costs as against pltffs' - Bonsal, J. Judgment ent 7-16-71-Clerk Ent-7-19-71
1972	
Mar. 27	Filed Joint pre trial memorandum
Mar. 27	Filed Consent Pre Trial Order - So ordered - Lasker, J.

Date	Filings - Proceedings
1973	
Jan. 30	Before Motley, J. Non-Jury trial begun.
Jan. 31	Trial continued.
Feb. 1	Trial continued on 2-2, 5, 6, 7, 8, 9, 13, 14, & trial concluded on 2-15-72, Decision reserved.
1974	
Jan. 23	Filed Opinion #40264-- This action involves the merger of a department store, Masters, Inc. (Master I) with Lady Rose Stores, Inc., (Lady Rose) in 1966. Under the terms of the merger, Lady Rose was merged into Master I and the new corporation now bears the name Masters. (Masters II) Pltffs., who represent the minority stockholders of the original Masters, seek to set aside the merger, or, in the alternative, as indicated. More specifically, pltffs., who bring this action as a class action and derivatively on behalf of Masters I, alleges that the merger was approved as the result of fraudulent misrepresentations in the proxy statement mailed to stockholders prior to the meeting at which the merger was approved. A judgment will be entered for defts. in accordance with this opinion. MOTLEY, J. mailed notice
Jan. 23	Filed Judgment - ordered that defts. Louis Biblowitz, et al. have judgment against the pltffs. Antoinette M. Bragalini, et al. dismissing the complaint. Clerk. (mailed notice)
Feb. 8	Filed notice of appeal that Antoinette M. Bragalini, Arnold Damsky, William Weinstock, Carl Rogers and Rose Rogers, H. L. Federman & Co., Suzanne Masters, Stephen Masters and Norman Kemper, individually and as stockholders of Masters, Inc. etc., pltffs. above named, appeal from final judgment entered on 1-23-74. Copies mailed to: Shea, Gould, Climenko & Kramer and Elias Schewel & Schwartz. Entered 2-11-74.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

- -x

ANTOINETTE M. BRAGALINI, ARNOLD DAMSKY, WILLIAM WEINSTOCK, CARL ROGERS and ROSE ROGERS, H. L. FEDERMAN & CO., INC., SUZANNE MASTERS, STEPHEN MASTERS and NORMAN KEMPER, individually, and as stockholders of MASTERS, INC., suing in behalf of themselves and for the benefit of said corporation and for the class of all other stockholders of said corporation similarly situated,

Plaintiffs,

-against-

LOUIS BIBLOWITZ, MAX BIBLOWIT, JOSHUA BIBLOWITZ, RALPH J.WEINER, JOEL BIBLOWITZ, ARNOLD GINSBURG, HERBERT ABRAMSON, HARRY GRUNTHER, HARRY L. LEWIS, PINCUS PETERSEIL, HERBERT KURTZ and MASTERS, INC.,

Defendants.

67 Civil Action No. 4988

- -x

AMENDED COMPLAINT

For Equitable Relief, Damages, and Other Relief Under The Securities Act of 1933, The Securities Exchange Act of 1934, And At Common Law.

1. This is a civil action - derivative, class, and individual - for equitable and other relief. This Court has jurisdiction by virtue of the provisions of 15 USCA §78aa and 78j; 28 USCA §1331; and on the principle of pendent jurisdiction.

2. Plaintiffs were shareholders of Masters, Inc. at the time of the transaction herein complained of; this action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have and plaintiffs fairly and adequately represent the interests of the shareholders

similarly situated in enforcing the right of Masters, Inc.

3. The class of stockholders of Masters, Inc. is so numerous that joinder of all is impracticable; the action presents questions of law and fact common to the class; the claims of plaintiffs herein are typical of the claims of the class; plaintiffs will fairly and adequately protect the interests of the class. This action falls within the Federal Rules of Civil Procedure, Rule 23(b)(1) (A) and (B) and (2) and (3).

4. Plaintiffs are and at all material times have been stockholders of Masters, Inc., a New York corporation, doing business in the County and City of New York, owning 60,105 9/27th shares of common stock, approximately 13% of the total issued and outstanding at December 22, 1966. The individual defendants, except Joel Biblowitz, are and at all material times have been the directors of Masters, Inc. and Louis Biblowitz, Max Biblowit, Joshua Biblowitz were the directors and together with Joel Biblowitz the sole stockholders of Lady Rose Stores, Inc., a New York corporation.

5. On January 26, 1967, the shareholders of Masters, Inc., over the protest of plaintiffs and other shareholders, authorized and directed the adoption of the plan and agreement of merger dated November 15, 1966 providing for the merger of Lady Rose Stores, Inc., into Masters, Inc. and shortly thereafter said merger was consummated.

6. To induce the shareholders of Masters, Inc. to thus authorize said merger, the individual defendants represented (Notice of Special Meeting of Stockholders, dated December 22, 1966, with accompanying letter to the stockholders and accompanying Proxy Statement) to them that the reason for the merger was

that it was "in the best interests of the stockholders of Masters, Inc." and that the "Directors believe that the terms of the merger are fair and equitable." Said representations were false, fraudulent and deceptive in that, as defendants knew and should have known, the merger was not in the best interests of the stockholders of Masters, Inc. but rather in the selfish interests of the individual defendants - stockholders of Lady Rose Stores, Inc., and the terms of the merger were grossly unfair to the stockholders of Masters, Inc., viz., they received, in effect, less than 12 percent of the stock in the surviving corporation whereas according to the respective fair market values and net worths of the two corporations they should have retained at least 41 percent of the stock in the surviving corporation. The said fraudulent representations were material and relied on by the stockholders to their damage in so authorizing said merger.

7. The principals in Lady Rose Stores, Inc., to wit, defendants, Louis, Joshua and Joel Biblowitz and Max Biblowit, controlled and dominated the board of directors of Masters, Inc., and controlled a majority of the issued and outstanding shares of Masters, Inc., at the execution of the merger agreement and have continued to do so at all times since then and the persons participating in the wrong have at all material times constituted and now constitute a majority of the directors and stockholders of Masters, Inc.

8. Lady Rose Stores, Inc. had four stockholders owning all of the issued and outstanding shares; consisting of three brothers and the son of one brother, to wit:

Louis Biblowitz	30%
Joshua Biblowitz	- 30%
Max Biblowit	- 30%
Joel Biblowitz	- 10%

Each of the above stockholders, with the exception of Joel Biblowitz, was at the time of the merger, a member of the Board of Directors of Lady Rose, and as a group constituted all of the members of the Board of Directors of Lady Rose.

In connection with the interests of the Biblowitzs in the proposed merger, the Proxy Statement (p.7) stated:

> "Interests of Directors and Officers and Their Associates in the Proposed Merger
>
> "Louis Biblowitz, Chairman of the Board of Directors of Masters, Inc., Max Biblowit and Joshua Biblowitz, directors of Masters, Inc. are stockholders, directors and the controlling persons of Lady Rose Stores, Inc. (See "Lady Rose Stores, Inc." herein) and are the persons who presented the Agreement of Merger to the Board of Directors of Masters for its consideration. In addition, said three individuals are voting Trustees under a Voting Trust Agreement among stockholders of Masters. Said Voting Trust Agreement controls a majority of the issued and outstanding capital stock of Masters. (See "Directors and Management" herein and accompnying footnotes thereto for further particulars as to other relationships with Masters of certain directors of Masters.) Lady Rose Stores, Inc. operates ladies' soft goods leased concessions in Masters' Stores, through corporate subsidiaries."
>
> "Lady Rose Stores, Inc. is the owner of 69,629 17/27 shares of the 460,732 outstanding stock of Masters ..."

The brothers Biblowitz are three directors out of ten directors on the Masters board of directors, and (i) Louis Biblowitz is Chairman of that Board, (ii) the Biblowitz brothers "are the persons who presented the Agreement of Merger to the Board of Directors of Masters for its consideration" (iii) the

principal signatory of the Agreement of Merger on behalf of Masters, Inc. was Louis Biblowitz as Chairman of the Board while his brother, Max Biblowit, as Vice-President was the principal signatory for Lady Rose Stores, Inc. (Proxy, p. 12), (iv) the Chairman of the Board of the surviving corporation is Louis Biblowitz (Proxy, p. 3); and (v) at least three other directors of Masters, Inc. (which together with the Biblowitzs constitute a majority of the Master's board), to wit, Messrs. Abramson, Lewis and Kurtz, either do business with Masters or Lady Rose or both and are thereby under the economic control and domination of the Biblowitzs (Proxy, p.4).

9. By virtue of the foregoing: (a) defendants have violated §17(a) of the Securities Act of 1933, 15 USCA §77q, §10(b) of the Securities Exchange Act of 1934, 15 USCA §78; and rule 10b-5 of the Rules of the Securities and Exchange Commission, and the common law duty of fiduciaries to act fairly in transactions between them and their beneficiaries; (b) the merger aforesaid is illegal under federal and state law; and (c) demand on the directors has been made and not acted upon and demand upon the directors or stockholders to remedy the above is, in any event, futile.

10. Plaintiffs have no adequate remedy at law.

WHEREFORE, plaintiffs pray for an order that their action insofar as brought as a class action may be maintained as such and demand judgment:

(a) That the merger aforesaid be set aside; or

(b) That the terms of the aforesaid merger be reformed so that they are just, fair and equitable;

(c) That if (a) or (b) not be practicable, that each stockholder of Masters, Inc. immediately prior to the merger who retained less than his fair share of the stock of the surviving corporation be compensated for the difference by the individual defendants;

(d) That the Court give such other, further and general relief as may be just, together with costs, disbursements and a reasonable fee for plaintiffs' attorneys.

LEVENTRITT, BUSH, LEWITTES & BENDER

BY: s/ Sidney Bender
a member of the firm

Attorneys for Plaintiffs
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YUkon 6-4080

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

WILLIAM WEINSTOCK, being duly sworn, deposes and says:

I am one of the plaintiffs united in interest and pleading together herein. I am familiar with all of the relevant facts herein. I have read the annexed amended complaint and know it to be true of my own knowledge, except as to matters therein stated to be alleged on information and belief, and as to those matters I believe it to be true.

S/ William Weinstock
William Weinstock

Sworn to before me this 24th
day of January, 1968.

S/ Barry Jacker
Notary Public

Judge Motley's Decision

10A

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

ENTER JAN. 23, 1974

ANTOINETTE M. BRAGALINI, et al.,

Plaintiffs,

-v-

67 CIV. 4988

LOUIS BIBLOWITZ, et al.,

Defendants.

APPEARANCES

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CONSTANCE BAKER MOTLEY, D. J.

OPINION, FINDINGS OF FACT,
CONCLUSIONS OF LAW

This action involves the merger of a department store, Masters, Inc., (Masters I) with Lady Rose Stores, Inc., (Lady Rose) in 1966. Under the terms of the merger,[1] Lady Rose was merged into Masters I and the new corporation now bears the name Masters. (Masters II). Plaintiffs, who represent the minority stockholders of the original Masters, seek to set aside the merger or, in the alternative, to have the terms of the merger reformed on the ground that the merger was effected in violation of the anti-fraud provisions of the Federal Securities Laws and defendants' common law fidiciary duties. They also seek damages for stockholders of Masters. Defendants are Masters I and the individual members of the Board of Directors of Masters before the merger.

More specifically, plaintiffs, who bring this action as a class action and derivatively on behalf of Masters I, allege that the merger was approved as the result of fraudulent misrepresentations in the proxy statement mailed to stockholders prior to the meeting at which the merger was approved. They assert that as a result of these misrepresentations and the resultant merger, their interest in the surviving corporation was substantially less than it would have been under a fairer agreement. Plaintiffs proceeded on the theory that the principal beneficiaries of the merger were three of the individual defendants, Louis Biblowitz, Max Biblowit and Joshua Biblowitz, who held controlling positions within both corporations. The Biblowitz' owned Lady Rose, a successful business. The original Masters had not been successful and had gone through a reorganization prior to the merger. Plaintiffs claim the individual defendants failed to disclose to the stockholders of Masters I all facts concerning their interests in Lady Rose and other facts the disclosure of which might have influenced the stockholders of Masters I to vote against the merger. For their pendent state claim, plaintiffs assert that defendants breached their fiduciary duties by promoting a merger plan which was unfair to Masters I and its minority stockholders.

The court finds for defendants on both the federal and state causes of action. The court's detailed findings of fact are set forth infra.

The 10-b-5 Claim.

Plaintiffs contend that the proxy statement (Plaintiffs' Exhibit 2) sent by management to the stockholders of Masters I contained a number of material omissions and misrepresentations which violate 15 U.S.C., § 78j(b) and Securities and Exchange Commission Rule 10(b)(5) promulgated pursuant thereto. However, that Rule 2/ prohibits only material misrepresentations and omissions. And the test of materiality is whether ". . . a reasonable investor might have considered. . .[the information] important in the making of. . .[his] decision." Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54 (1972). As the Second Circuit said: " 'The basic test of materiality. . .is whether a reasonable man would attach importance. . .in determining his choice of action in the transaction in question. . . .' [citations omitted] This, of course, encompasses any fact '. . . which in reasonable and objective contemplation might affect the value of the corporation's stock or securities. . .'" SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).

As a corollary to the materiality requirement, plaintiffs cannot recover unless reasonable investors would have attached importance to the facts at issue. If the facts allegedly omitted are reasonably available to the plaintiffs, they cannot recover. See, e.g., Hafner v. Forest Laboratories, Inc., 345 F.2d 167, 168 (2d Cir. 1965); 2A. BROMBERG, SECURITIES LAW: FRAUD, SEC RULE 10b-5 204.249 (Supp. 1971). But for the materiality requirement, stockholders might be so overwhelmed with information that their ability to make an informed decision, based on a consideration of relevant, significant information, would be diminished. Moreover, a misrepresentation or ommission, in the absence of a fraudulent intent, is actionable only where the care exercised by defendants falls below that standard of care which will promote ". . .the deterrence objective of the Rule." Texas Gulf Sulphur, supra, at 855. While this standard is difficult to define, the scienter requirement can be termed ". . . lack of diligence, constructive fraud, or unreasonable or negligent conduct. . . ." Id. at 855. Also, to establish a 10b-5 violation, plaintiffs must show reliance and causation. The test of reliance and causation is whether the misrepresentation is a substantial factor in determining the course of conduct which results in the recipient's loss. List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir.), cert. denied, 382 U.S. 811 (1965).

Although, under some circumstances, the ". . .obligation to disclose and. . .[the] withholding of a material fact [are sufficient to] establish the requisite element of causation in fact." Affiliated Ute Citizens, supra, at 154.

The court holds that none of defendants' alleged omissions was "material" since reasonable stockholders would not have attached importance to them. Given the poor financial condition of Masters I at the time the merger was approved[3/] and the fact that this condition was generally known[4/] to the stockholders, it is doubtful that reasonable stockholders would have attached much importance to the facts defendants omitted from the proxy statement.

The court will discuss each of the more significant omissions and misrepresentations alleged by plaintiffs in turn. The court will consider those points relevant to each of the alleged omissions and misrepresentations other than the lack of materiality discussed supra.

1. The Biblowitzes' Controlled Masters I.

The court finds that there was no omission or misrepresentation, material or otherwise, since the proxy statement disclosed that Louis Biblowitz, Max Biblowit and Joshua Biblowitz were Voting Trustees under a Voting Trust Agreement among stockholders of Masters I. "Said Voting Trust Agreement controls a majority of the issued and outstanding capital stock of Masters." (Exh. 2, p. 7). The powers of the trustees to vote at stockholders' meetings on behalf of the trust were set forth in Exhibit D, appended to the proxy statement, Exhibit 2.

2. Louis Biblowitz Fixed The Terms Of The Merger Both For Lady Rose and Masters I.

The proxy statement reported: "Louis Biblowitz, Chairman of the Board of Directors of Masters, Inc., Max Biblowit and Joshua Biblowitz, directors of Masters, Inc., are stockholders, directors and the controlling persons of Lady Rose Stores, Inc. . . .and are the persons who presented the Agreement of Merger to the Board of Directors of Masters for its consideration." (Exh. 2, p. 7.)

The obvious implication of this statement was that at least the basic terms of the merger were presented to the board of Masters I by the Biblowitz brothers. Since the proxy statement disclosed that the Biblowitzes controlled Lady Rose, it would have to be assumed that they set the terms for Lady Rose.

3. Kalish, Rubinroit, The Accountants For Masters And Lady Rose, Had Been Working At The Behest Of Mr. Biblowitz In Preparing A Plan Of Merger Without Disclosing That Fact To Masters I And That Kalish, Rubinroit Were Mr. Biblowitz's Personal Tax Advisers And Would Receive $42,000 In Fees For Their Work On The Merger.

Reasonable stockholders who had doubts about the fairness of a merger agreement between two corporations dominated by the same family might attach great weight to the financial information certified by independent accountants. Therefore, it would be important that the stockholders be informed that Kalish, Rubinroit were working for the Biblowitzes.

While the proxy statement could have made the divided loyalties of Kalish, Rubinroit clearer, their employment by Masters I and Lady Rose was disclosed. Page FS-10 of the statement set forth Kalish, Rubinroit's certification to the board of directors and stockholders of Lady Rose that the financial

statements presented fairly the financial position of Lady Rose. Since the proxy statement clearly revealed that the Biblowitzes owned Lady Rose, Kalish, Rubinroit's employment by the Biblowitzes should have been inferred by reasonable stockholders. That they were also the accountants for Masters I was obvious from page FS-1 which contained a copy of their certification to the board of directors and shareholders of Masters I. (Pls.' Exh. 2.)

While disclosure of the various services Kalish, Rubinroit performed for Mr. Biblowitz as his personal tax advisers would have put Kalish, Rubinroit's relationship to the Biblowitzes into sharper relief, the court does not believe that this fact was material in light of the proxy statement's revelation that Kalish, Rubinroit was working for Lady Rose.

Plaintiffs do not explain the materiality of the fees paid to Kalish, Rubinroit for their work in connection with the merger. Masters' stockholders would have assumed that the accountants were being compensated by both Masters I and Lady Rose for their services. No evidence was introduced that their fees were contingent upon approval of the merger.

It is difficult to understand the relevance of plaintiffs claim that the stockholders of Masters I should have been

informed that Kalish, Rubinroit ". . .had been working at the behest of Mr. Biblowitz in preparing a plan of merger without disclosing that fact to Masters I. . . ."

Since it is plaintiffs' claim that the Masters I board was controlled by the Biblowitzes and since the proxy statement revealed the Biblowitzes' control to the stockholders, it is difficult to see how the stockholders could have relied on the judgment of the directors in approving the merger even if the omission led them to believe that the board had been fully informed about how the agreement was prepared.

4. One Of The Masters I Directors Voted Against The Merger.

The merger proposal was approved by the directors on November 7, 1966. One director, Herbert Kurtz, voted against the proposal. Plaintiffs claim that the statements in the letter from Louis Biblowitz accompanying the proxy statement that the board of directors had approved a merger agreement and recommended approval of the merger as being in the best interests of Masters was a material misrepresentation in the absence of a statement that one director had opposed the agreement.

However, it is doubtful that reasonable stockholders would have construed Mr. Biblowitz's letter as stating that the vote of the directors was unanimous.

5. The Operating Losses Of Masters I For The Six Month Period Ending July 30, 1966 Were Due Almost Entirely To The Discontinued Florida Operations.

Defendants contend that losses from discontinued stores in a retail chain did not have to be segregated since the opening and closing of stores is an ordinary aspect of a retail chain's business. Moreover, defendants offered evidence that it would have been impossible to estimate the extent of the losses attributable to the discontinued Florida stores since defendants could not ascertain to what extent central overhead expenses of Masters I would be reduced as a result of the closings or how overhead expenses should be allocated between the Florida and Metropolitan stores.

However, the court regards the closing of the apparently most unprofitable stores within a small chain to be a fact of enough importance that stockholders should be informed not only of the sale but also, to the extent possible, of the losses attributable to the discontinued operations. See Accounting

Series Release No. 153, CCH FEDERAL SECURITIES LAW ¶72,071 (". . .[D]isclosure should be as to significant, known factors tha might render past earnings statements, or particular items therein, not indicative of probable future operations.")

While it might well have been impossible to pinpoint the extent of the losses attributable to the Florida operations during the six month period ending July 30, 1966, the stockholders should at least have been informed that a substantial proportion of the losses were attributable to discontinued operations.

Nevertheless, while such an omission would ordinarily be "material" within the meaning of Rule 10-b-5, the court finds that the omission was not "material" in this case. However much the omission may have resulted in an overstatement of the poor condition of Masters I, reasonable stockholders aware of Masters' unpromising prospects would not have attached substantial importance to the fact omitted for the reasons stated supra.

6. The Financial Statement Of Lady Rose Took Account Of Operations In Florida Which Had Been Discontinued.

Upon the sale of Master Florida stores to Zayre Corporation in 1966, Lady Rose's concessions in those stores were terminated. Plaintiffs contend that the proxy statement should have disclosed this loss of a future source of income in its reporting of Lady Rose's net income for the six months ended August 31, 1966.

Plaintiffs argue that omission of this fact led stockholders to believe Lady Rose's future earnings would be higher than could reasonably be anticipated given the loss of the Florida concessions.

However, in view of Lady Rose's strong condition, the absence of any evidence that the Florida concessions were unusually profitable to Lady Rose and Lady Rose's large number of concessions at the time of the merger, the court concludes that the termination of the Florida concessions was not, for Lady Rose, such a ". . .significant, known factor[s] that might render past earnings statements not indicative of future operations." Accounting Series Release No. 153.

7. Masters Was Valued At Only $770,000 For Purposes Of The Merger.

Masters I was valued at $770,000 for purposes of the merger. This was obviously important. However, there was

nothing in the proxy statement which would have led the stockholders to believe that Masters I had been assigned a higher value. While the letter accompanying the proxy statement reported that the terms of the merger were "fair and equitable," the court has found that the terms of the merger, including the value assigned to Masters I, were indeed "fair" to Masters' stockholders.[5/]

Nor can the court find that, given the poor condition of Masters I, the valuation given Masters was so low that reasonable stockholders might have considered the information as to the $770,000 valuation important in the making of their decision.

8. No Value Was Placed On The Tax Loss Carryforward Of Masters I.

The court, for similar reasons, rejects this claim. There was nothing in the proxy statement which would have led reasonable stockholders to believe that a value had been assigned the tax loss carryforward.

Moreover, given the evidence that tax loss carryforwards are ordinarily not assigned values in merger agreements[6/] the court cannot find that failure to assign a value to Masters' carryforward was so unusual that reasonable stockholders would have assumed that a value had been assigned or that they would have

attached importance to the fact it was not assigned a value.

9. The Assertion In The Proxy Statement That "[t]he Terms Of The Merger Were Arrived At As A Result Of Negotiation Between The Respective Managements Of Masters And Lady Rose. . .," (Exh. 2, p. 1) Was A Misrepresentation Since The Biblowitzes Dictated The Terms Of The Merger.

However, the directors of Masters did rais objections to several terms of the merger proposal during the Masters board meeting in what might be termed negotiations with the Biblowitzes, owners of Lady Rose. Obviously, negotiations between the managements of the two companies would be virtually meaningless since the Biblowitzes controlled both managements. However, the fact of the Biblowitzes' control was disclosed to the stockholders. At any rate, any misrepresentation cannot be deemed "material" for the reasons stated at p. 6 supra.

10. Finally, Plaintiffs Claim That The Assertion Contained in Louis Biblowitz' Letter To The Stockholders That The Merger Was "fair and equitable" Was A Misrepresentation Of A Material Fact.

The court rejects this claim since it finds that the terms of the merger were fair to the Masters stockholders. 7/

Because of the court's findings with regard to materiality, it need not consider the scienter and causation elements of plaintiffs' claim.

Pendent State Claim

Plaintiffs also claim under New York law that the individual defendants violated their fiduciary duties to the stockholders of Masters I by approving a merger agreement which attached too high a value to Lady Rose and too low a value to Masters I.

The individual defendants concede that they, as directors of Masters I, ". . .stood in a fiduciary relationship to Masters, Inc. and to its shareholders and since the boards of directors of Masters, Inc. and Lady Rose Stores, Inc. contained common directors, the burden of proof is upon the individual defendants to prove that the terms of the merger were fair and reasonable." (Proposed Conclusions of Law of Individual Defendants ¶8).

Defendants must show that they acted in ". . .an open, fair, and honest manner." Norwegian-American Securities Corp. v. Schenstrom, 207 N.Y.S. 163, 166, 124 Misc. Rep. 225 (Sup. Ct. N.Y. Cty. 1924). Defendants satisfied this burden.

First, they acted fairly in appraising Masters I at $770,000. They could certainly have reasonably concluded that a merger was essential to the company's survival in view of its poor economic condition and need for additional capital to permit the opening of more modern, viable stores.

Moreover, they knew that there were few companies which had expressed any interest in purchasing or merging with Masters I on terms even remotely as favorable as those offered by Lady Rose.

With respect to tax loss carryforward of Masters I, to which plaintiffs' expert assigned a value of at least $800,000, the court finds that it was reasonable for Masters' board to have assigned no value to the carryforward.

As defendants' expert, Mr. Whitman, testified, it was uncertain at the time of the merger whether the combined Masters-Lady Rose operation would enjoy sufficient profits to fully utilize the carryforward, what the size of the carryforward would be, and whether the new corporation would be permitted to utilize it. [8] Furthe Lady Rose could, as a result of the merger, expect to be placed in a higher tax bracket since, prior to the merger, it did not file consolidated returns. Finally, as Lawrence M. Rosenthal, an underwriter testified, there were few, if any, instances in which a value has been assigned to a carryforward in merger agreements. All these

factors made it reasonable for the Masters board to conclude that a value should not be placed on the carryforward.

The court further finds that the Masters I board acted reasonably in assigning a value of $6,000,000 to Lady Rose. The court found the report and testimony of defendants' expert, Mr. Whitman, more persuasive than those of plaintiffs' expert, Mr. Marx.

Mr. Marx's argument that the benefit to Lady Rose of retaining their concessions in the Masters stores should have been substracted from Lady Rose's value was given little weight in view of Lady Rose's large number of concessions, its economic strength and presumed ability to find other concessions.

Finally, the court finds that the Biblowitzes and other members of the Masters I board who had loyalties to Lady Rose, acted in an "open" and "honest" manner. The interests of the Biblowitzes in Lady Rose and the interests of the other directors in Masters I, and hence, their ties to the Biblowitzes, were set forth in the proxy statement. (Plaintiffs' Exhibit 2, pp. 4-5).

The foregoing findings of fact and conclusions of law are based upon the detailed findings which follow.

DETAILED FINDINGS OF FACT

Masters is engaged in the discount business selling a complete line of department store items, including such items as refrigerators, freezers, television sets, radios, phonographs, housewares, giftwares and cameras ("hard goods"). It leases departments to various concessionaires for the sale of ladies', girls' and children's wear, men's and boys' wear ("soft goods"), shoes, jewelry, books and stationery. From 1937 to 1956, it operated a single store on 48th Street, New York, New York. From 1956 to 1962, it added nine stores. On January 31 1963 it filed for reorganization under Chapter XI of the Bankruptcy Laws.

Lady Rose and its predecessor have been engaged in the retail sale of ladies soft goods and apparel for 45 years. Lady Rose has enjoyed a profit every year. (Tr. 236, 237). Its sole stockholders were members of the Biblowitz family (Exh. 25, p. 12).

As of December 31, 1962, the 500,000 shares of Masters common stock then outstanding was held as follows:

The Masters Family

Winifred Masters	16, 441
Stephen Masters	122, 998
Masters Trust	150, 787
Philip Masters, Jr.	72, 888
Estate of David H. Ormont	5, 176
Suzanne Masters	2, 403
	370, 693

1% Shareholders

W. Weinstock	12, 018
J. Haizen	9, 111
S. Peck	8, 325
H. & M. Lewis	7, 388
M. & M. Hoffenson	13, 755
Lehr Distributors	5, 314
S. Mailman	6, 470
R. Steel	6, 009
	68, 390

In addition, another 43 individuals, unrelated to the Masters family and none of whom owned as much as 1% of the then outstanding common stock, owned an aggregate of 60,917 shares. (Exh. 25, p. 4).

On or about April 11, 1963, and prior to the adoption of a Plan of Arrangement, a group led by several of the concessionnaires, including Lady Rose, which operated concessions in Masters, purchased 235,000 shares, a majority interest in Masters, from members of the Masters family and put the stock in a voting

trust (Exh. 25, pp. 5, 7). Louis Biblowitz was elected chairman of the voting trust, not in a control or executive capacity, but rather in an administrative capacity (Tr. 499, 500).

On July 29, 1963, a 40% Plan of Arrangement (Plan) for Masters I was adopted. To enable Masters to continue to operate its business and to comply with the condition in the Plan that an unsecured subordinated loan be obtained by Masters, principally Lady Rose and other purchasers of the majority stock interest in Masters purchased subordinated loans from Masters for $283,000. The subordinated loans provided that the lenders had the right to purchase shares of Masters common stock as follows:

(a) Three shares of the common stock of Masters, par value, $1.00 per share, for every one dollar of loan extended at a price of $1.25 per share if purchased on or before December 27, 1966;

(b) Three shares of the common stock of Masters, par value, $1.00 per share, for every one dollar of loan extended at a price of $2.00 per share if purchased on or before December 27, 1968;

(c) Upon the exercise of the option, such portion of the sums loaned, together with accrued interests as required, might be applied to any sums due Masters by reason of the exercise of said option (Exh. 2, p. 8).

Members of the purchasing group or their representatives who are defendants in this action are:

Name	Shares Purchased		Loan Purchased
Messrs. Biblowitz (Lady Rose)	69,629	17/27	$80,000
A. Ginsburg	26,111	3/27	30,000
P. Peterseil	26,111	3/27	30,000
H. Abramson (S.Scheller & Co.)	21,759	7/27	25,000
Ralph Weiner	6,527	21/27	7,500
Harry Grunther	6,527	21/27	7,500

Defendant Lewis, purchased $5,000 of the subordinated loan (Exh. 2, p. 4).

The purchasers of control of Masters paid $1.15 per share (Tr. 764). The current assets of Masters on April 30, 1963, shortly after the purchase, were $5,315,974; current liabilities wer $2,068,184 (Exh. AH, p. 3); its working capital was $3,247,790 and its net worth was $2,718,092 (Exh. AH, p. 3). Masters had a tax loss carryforward for the year ended April 30, 1963 of $274,045 (Exh. 1).

The Plan of Arrangement imposed severe restrictions on the management of Masters, including limitations on compensation of officers and directors and payment of dividends.[9/]

Shortly after the Plan was adopted, Masters had five stores: 48th Street, New York, New York; Elmsford, New York; Lake Success, New York; Flushing, New York; Central Plaza, Miami,[10/]

Florida. In 1964, with the approval of the Creditors Committee, it opened two more stores in Florida in order to spread its overhead. The sources of the funds to open the new stores were the company's cash funds ($400,000), the sale of debentures ($412,000), and an increase in its obligations to its trade creditors ($1,000,000).

The 48th Street Store had 22,913 square feet on four floors with an elevator in the lobby, outside the store. By 1966, it needed refurbishing, had a serious pilferage problem and a high overhead. This store had never shown a profit and the situation at the store was a deteriorating one. As early as August, 1966, Masters was negotiating to renew the lease because Jack Haizen, then the president of Masters and Kenneth Kopelson, the chief financial officer, advised the board that Masters could not operate with its overhead spread over only three stores. Moreover, they advised that since 48th Street was Masters' original store, its continued operation was essential to the corporation's image. The landlord, however, would not accept Masters' credit and Masters was required to deposit $50,000 as security to renew the lease. The store was eventually sold because of its continuing losses.

The Flushing store was likewise a four-floor operation which had never made money and which, by 1966, required refurbish

The Lake Success store was for accounting purposes at best a break-even operation. In 1966, it was in poor condition and was spread over two floors in two buildings.

The Elmsford store was the only one that generated profits. However, it needed refurbishing and had to relinquish part of its space to a bank. After the merger of Lady Rose into Masters, it was refurbished at a cost of more than $600,000 and a liquor store was added.

As of 1966, Masters did not have the proper assortment or quantity of merchandise to continue as a mass merchandiser and the merchandise which it did have was soiled, damaged and stale. The stores were inadequate and the operation outmoded.

Beginning in early 1966, Lady Rose had attempted to find new management for Masters I. Lady Rose employed a management consultant and tried unsuccessfully to hire several new management people.

Masters' financial condition in 1966, both before and after the sale of the three Florida stores to Zayre Corp., was precarious. The Florida stores had been losing money, three of the metropolitan stores were unprofitable and Masters' credit standing with its suppliers was poor.

In the opinion of Masters' counsel, its chief financial officer and its directors who testified at trial, Masters, in 1966, was headed for another bankruptcy.

According to Mr. Kopelson, Masters' chief financial officer, the principal cause of Masters' failure to realize profits was in its inability to sustain a reasonable volume with a reasonable gross profit. When it succeeded in raising its gross profit, it suffered concurrent losses in volume. It could not take advantage of an advertising umbrella, i.e., the coverage of a geographic area with a minimum run of a newspaper to spread that cost over a number of stores. This problem was particularly acute in the metropolitan stores and its advertising costs were exceedingly high in relation to the volume generated because each store had to absorb its own high advertising costs. Masters was at a severe advertising disadvantage in Manhattan, in Queens and in Westchester, with respect to each of its metropolitan stores since it was necessary to run advertisements in newspaper editions having circulations much broader than the areas from which the stores drew their customers. This placed Masters at a competitive disadvantage with other retailers of major appliances which could take advantage of the advertising umbrella.

According to Kopelson, Masters had attempted to increase its gross profits and to reduce its operating expenses. However,

when it reduced its advertising expenses, it found that its volume dropped. Moreover, when it reduced its payroll, it was unable to adequately staff its stores and found that by reducing its gross dollar payroll expense it actually had increased the ratio of payroll expense to total volume.

From April 30, 1963 (after adoption of the Plan of Arrangement) to July 30, 1966, Masters' working capital had declined from $3,247,790 to $1,738,653; its net worth dropped from $2,718,092 to $1,781,174; and its retained earnings fell from $1,367,920 on May 2, 1964 to $580,604 (Exh. AQ). Moreover, these statistics do not reflect the poor state of the inventories and the lack of funds available to metropolitan Masters to make expenditures necessary to expand the number of stores and refurbish the existing stores in order to make Masters a viable operation.

By 1967, Masters had a tax loss carryforward as follows:

Year of Operating Loss	Carry-forward Loss	Date of Expiration
4/30/63	$274,045	1/31/68
5/2/64	$2,200,423	1/31/69
5/1/65	$32,304	1/31/70
1/31/66	$72,077	1/31/71
1/31/67	$800,000 (est.)	1/31/72
	$3,378,849	

For the year ended May 2, 1964, on sales of $19,074,937, Masters reported a net loss of $52,588.

For the fiscal year ended May 1, 1965, Masters reported an operating income of $31,995, before taxes, and, after realizing income from prepayment of long-term obligations, only $79,212 on sales of $29,659,768 (Exh. 129).

For the nine months ending January 29, 1966, Masters reported a loss of $71,713 (Exh. 2, p. FS-3) and for the quarter ending April 30, 1966, it reported a loss of $188,024 (Exh. AI). For the six months ended July 30, 1966, it reported a loss of $794,815, including a stated operating loss of $212,294 for its discontinued Florida division and a non-operating loss of $561,367 on the sale of the Florida stores.

According to the report of Lehrer & Abrams & Co., the accountants for the Creditors Committee of Masters, for the 39 weeks ended October 29, 1966, Masters reported a net loss of $996, 443 as compared with a loss of $558,596 for the same period the year before. For the 13 weeks ended October 29, 1966 the four metropolitan stores reported a loss of $201,618 as compared with a reported loss of $189,641 for the four metropolitan stores and three Florida stores for the same period during the prior year. In short, for this quarter the four metropolitan stores reported losses of more than those reported for the combined

metropolitan and Florida stores during the same quarter the year before (Exh. O, p. 3). Masters sustained operating losses of $252,000 in its Florida division for the six months ending October, 1965 and of $158,702 for the nine months ending January 29, 1966. Of the estimated loss of $800,000 for fiscal 1967, over $773,000 was attributable to the discontinued Florida division. (Stipulated Fact, Pre-trial order, p. 4).

In July, 1966, Masters, as a first step in an attempt to improve its condition, sold its three Florida stores to Zayre Corp. which assumed none of Masters' liabilities other than its leases. The sale was made by Masters in order to stem losses and to realize some cash in order to attempt to stay in business (Tr. 429, 554, 555, 865, 866, 1598, 1599; Exh. BF; Exh. 2, n. 8, p. FS-3).

Because of the lack of bargaining power of Masters resulting from its continual losses and because of its inferior inventory, the sale to Zayre Corp. resulted in a loss to Masters of $561,367 (Exh.2, p. FS-8). On the other hand, because of the high quality of its merchandise, Lady Rose was able to recover its cost for the merchandise at the Florida stores after its concessions were terminated by Zayre.

As a result of the sale to Zayre, Masters had a stated net cash inflow of approximately $1,508,000 after a full retirement of its Subordinated A and B Debentures in the amount of $250,000 and $162,000 (Stipulated fact, pre-trial order, p. 3).

The proceeds of the sale of the Florida stores were used for payment of creditors, retirement of the subordinated A and B debentures (Tr. 1951), and acquisition of shares from Mr. Haizen, in return for the termination of his contract. (Exh. 5).

While the sale of the Florida stores helped reduce the drainoff of working capital, it appears that Masters I continued to be in a difficult position.

As of September 6, 1966, Masters had a remaining indebtedness to Chapter XI creditors (originally $1,400,000) of $393,000 and payments under the Plan of Arrangement would in the ordinary course be completed on or about November, 1967.

Louis Biblowitz at the Annual Meeting of Stockholders of Masters, Inc., on September 8, 1966 after the sale to Zayre, stated, in response to a comment from shareholders of Masters that the attention of the Board of Directors should be directed to the possible shift of Masters' operations to a full concessionaire operation, that no change in the operational policy of Masters was contemplated.

The Board of Directors of Masters on September 8, 1966 authorized the renewal of the company's lease of the premises at 64-70 West 48th Street for a term of 5 years commencing May 1, 1967.

As of July 30, 1966, after the sale to Zayre, the working capital of Masters was $1,856,595 and its book value was $1,677,438 or $3.70 per share. (Stipulated facts, pre-trial order, pp. 3-4).

The Biblowitzes attempted to find persons interested in buying Masters. However, little interest was expressed in purchasing the company. Only one offer was made. Under the terms of that offer, Time Square Stores would acquire Masters by paying Masters' shareholders out of any future Masters' profits. This offer was rejected. (Tr. 880-881).

The Masters board of directors was kept informed of the company's financial instability, losses, the attempts to find new management and efforts to find a buyer for Masters.

Lady Rose's financial position was much stronger. From February 29, 1964 to August 31, 1966, its working capital had risen from $835,701 to $1,821,070; its net worth from $1,447,469 to $2,532,200; and its retained earnings from $1,227,394 to $2,312,125 (Exh. AQ).

While Lady Rose's income was steadily increasing, its dependence on income from Masters was lessening (Tr. 1772).

Lady Rose Income

Fiscal Year Ended	Total Net Income	From Masters Metropolitan Stores	From Masters Florida Stores	% From Masters
2/29/64	$205,397	$59,121	$8,212	33.2 (Exh. AO)
2/28/65	301,262	67,971	27,379	31.6 (Exh. AP)
2/28/66	451,977	79,220	63,621	31.7 (Exh. AU)
6 mos. ended 8/31/66	331,491	48,710	44,618	28 (Exh. 136)
11 mos. ended 1/28/67	527,000	84,000	47,000	24.8 (Exh. 133)

As of December 22, 1966, Lady Rose's wholly owned subsidiaries operated leased departments in 21 locations. (Exhibit 2, p. 10).

The Lady Rose concessions in the Masters stores in the metropolitan area were to expire on January 31, 1967. The Lady Rose net income derived from those concessions was as follows:

	Before Tax	After Tax
2/29/64	$86,754.59	$59,121.92
2/28/65	101,850.26	67,971.88
2/28/66	126,316.30	79,220.03
6 mos. ended 8/31/66	71,930.99	48,710.99

Under its concession agreement with Masters, Lady Rose's subsidiaries paid Masters at a rate of 8 1/2% of sales in excess of $474,117, plus $40,300 at its concessions in the Masters' stores in Flushing and Elmsford and at the Masters' Lake Success store 7 3/4% of gross sales plus $32,500.[11/]

In 1966 Rockower Bros. negotiated a renewal of its concessions in Masters' stores expiring December 31, 1966 and agreed to pay a fixed minimum plus a percentage of sales in excess of a dollar amount based on an effective rate of 10%, which was an increase over the existing rate of 8 1/2%. The Rockower concession was renewed for a period of three years expiring on December 31, 1969. (Stipulated facts, pre-trial order, pp. 9-10.)

Lady Rose had received substantial income from its concessions located in Masters stores.

During the spring of 1966, Louis Biblowitz, (after conversations with others concerning a possible association with Masters had not materialized (Tr. 882)) discussed with Bernard Mintz, a partner of Kalish, Rubinroit & Co., independent certified public accountants, the tax and accounting aspects of a possible merger between Masters and Lady Rose (Tr. 1491, 1492).

Kalish, Rubinroit at that time was the independent certified public accountant for both Lady Rose and Masters; they had become Lady Rose's independent certified public accountants as a result of the recommendation in 1962 of Haizen, who was then with Masters (Tr. 1694).

Kalish, Rubinroit was the accountant for Lady Rose and Masters up through January 31, 1967; its annual fee was $25,000 from Masters and $15,000 from Lady Rose. After the merger Kalish, Rubinroit was the accountant for the merged company.

Kalish, Rubinroit rendered professional services in the sale of the Miami, Florida, stores to Zayre in 1966. Kalish, Rubinroit, in addition to its annual retainer, billed and was paid $25,000 by Masters in August, 1966; in addition, Kalish, Rubinroit billed and was paid $2,000 by Masters for the preparation of the financial statements included in the proxy statement relating to the merger with Lady Rose.

In May, 1967 the firm billed and was paid by Lady Rose, then a division of Masters, $42,000 in additional fees above retainer as agreed with the Biblowitzes for accounting services relating to periods prior to January 28, 1967. (Stipulated facts, pre-trial order, p. 8).

Louis Biblowitz's reasons for considering a merger between Lady Rose and Masters were his desire to be a landlord instead of a tenant, 12/ to own a larger interest in Masters and his disinclination to be associated with an operation which since 1963 had lost money and which would continue to lose money without financial assistance. Moreover, Mr. Biblowitz testified that he felt a sense of responsibility toward friends who had invested in Masters at his behest and was confident that he could turn Masters into a profitable entity. (Tr. 1472-3).

While Louis Biblowitz was in favor of the idea of a merger, his two brothers initially opposed the idea. Max Biblowit strenuously opposed a merger on the ground that if Lady Rose's net worth were put into a losing company, Lady Rose could be dragged down and be foreclosed from taking advantage of other opportunities.

Rubinroit, Lady Rose's accountant, also advised against a merger. (Tr. 1696).

At about the same time, Lady Rose was considering a public offering and during the spring and summer of 1966, officers of Lady Rose consulted with Lawrence M. Rosenthal, of L. M. Rosenthal & Co., underwriters and investment bankers.

When Louis Biblowitz mentioned to Rosenthal the possibility of a merger between Lady Rose and Masters, Rosenthal told

him that a merger might complicate the public issue since Masters had recently gone through a reorganization which gave it a "clouded name" and that it would be more sensible to attempt to aid the Masters I operation through means other than a merger. While he advised Biblowitz that there would be some disruption of Lady Rose's operations if Masters went bankrupt and that Lady Rose might gain Masters' tax loss carryforward, a public offering would be more beneficial to Lady Rose than a merger and a merger would delay the public offering at least two years. (Tr. 1049-50).

Rosenthal further advised Biblowitz that any benefit to Lady Rose arising from its inheriting Masters' tax loss carryforward after a merger might be less important than Masters' "lack of earning power" which originally produced the carryforward.

During the spring, summer and fall of 1966, discussions of a possible merger were conducted among the Biblowitzes, Rubinroit, Rosenthal, Mintz, Sassower and Ward (special counsel to Lady Rose). (Tr. 1496).

These meetings concerned the economics of a merger, especially the accounting and tax aspects and the valuations to be assigned the two companies.

Lady Rose's apparently healthy condition was contrasted

with the less profitable condition of Masters during these meetings. (Tr. 1496-98).

In August, 1966, when the Biblowitzes ascertained that Lady Rose would show a net profit of $327,000 for the first six months with the historically better six months yet to come, they forecast that Lady Rose would earn $600,000 after taxes for the twelve months ending January 31, 1967 (Tr. 452). Included in this estimate were the profits from the Florida stores in which Lady Rose had concessions and the profits from new concessions which Lady Rose had obtained in 1966 (Tr. 804).

While this projection took into account profits from the Florida concessions which had already been discontinued at the time the projection was made, the estimate seems reasonable since, on the basis of the seasonal pattern evident during the prior year, Lady Rose's earnings, with the Florida concessions, would have been $898,000. (Tr. 1843).

At a meeting held on August 22, 1966 and attended by the Biblowitzes, Ward, Mintz, Sassower, Rosenthal and others, Rosenthal appraised a merged enterprise at $6,694,740, valuing Masters at 9.03% and Lady Rose at 90.97%. (Exh. X).

Rosenthal's valuations were based on his assumptions that, after a merger, Masters would not go bankrupt, the merged

company would have available to it Lady Rose's earnings in order to take advantage of Masters' tax loss carryforward and that Lady Rose could continue to operate its concessions in the Masters' metropolitan stores. (Tr. 1087).

However, Rosenthal testified that he knew of no way to assign a value to a tax loss carryforward and that he knew of no instances in which a value had been assigned to a tax loss carryforward. (Tr. 1050-51).

While it was initially contemplated that Lady Rose would be the surviving company after the merger, it was later decided that, primarily in order to take full advantage of the tax loss, Masters would be the surviving company. (Tr. 1517).

In September, 1966, Haizen resigned as operating head of Masters apparently because of the directors' dissatisfaction with his performance. He was succeeded by Kopelson who was to serve as an interim president. (Tr. 532).

On or about October 5, 1966, Mintz prepared a data sheet showing a valuation of Lady Rose at $6,000,000 and of Masters I at varying amounts between $650,000 and $800,000. Lady Rose's equity in the proposed entity would accordingly be between 86.147% and 88.847%. (Exh. AG; Tr. 1499).

Louis Biblowitz then made the final decision on behalf of Lady Rose to value Masters at somewhere between $750,000 and $800,000, or $1.65 and $1.76 per share for purposes of the merger. (Tr. 1432).

Based upon the valuation of $6,000,000 for Lady Rose and between $750,000 and $800,000 for Masters, the Lady Rose ownership of the proposed merged entity would be approximately 87.7% and Masters' shareholder's ownership approximately 12.3%. (Tr. 1502).

Based upon the $6,000,000 valuation for Lady Rose and the $750,000 to $800,000 valuation for Masters and assuming that the proposed merged company could generate profits against which the tax loss carryforward could be used, the Mintz data sheet contemplated a maximum utilization of between 61.275% and 63.965% of the tax loss carryforward (Exh. AG, Tr. 1503) because for each percentage point under 20% of the proposed merged company owned by the Masters' shareholders, 5% of the available tax loss carryforward would be lost (Tr. 1493).

These data contemplated that the 9% subordinated notes issued by Masters would be converted into shares of common stock of the proposed merged entity (Exh. AG; Tr. 1500).

The final percentage of Lady Rose owenership of the merged company of 89.95% resulted from the fact that the 9% subordinated notes were not converted into common stock of the merged entity and also from the redemption by Masters of 44,000 shares of its stock owned by Haizen (Tr. 1518-1521).

Subsequent to October 6, 1966, one of the professionals advising the Biblowitzes proposed using another class of stock with no voting rights in the merger to enable the proposed merged entity to utilize 100% of the tax loss carryforward rather than the 61.275% to 63.965%, provided the proposed merged entity had profits to offset against Masters' prior losses (Tr. 1505-06).

On October 31, 1966, the Masters board of directors met to consider the proposed merger.

Masters at the time of the meeting had the following named directors: Louis Biblowitz, Chairman of the Board, Max Biblowit, Joshua Biblowitz, Arnold Ginsburg, Herbert Kurtz, Herbert Abramson, Ralph J. Weiner, Harry Gunther, Harry L. Lewis, and Pincus Peterseil.

Louis Biblowitz, Max Biblowit and Joshua Biblowitz were also the directors of Lady Rose Stores, Inc. and with Joel Biblowitz, the son of Louis Biblowitz, owned all of the outstanding shares of Lady Rose Stores, Inc.

Herbert Abramson was the President of Samuel Scheller & Co. Inc. which was a licensed insurance brokerage firm which acted as the insurance broker for Masters and Lady Rose.

Harry L. Lewis and his wife were the owners of the land and buildings in Elmsford, New York, tenanted by Masters.

Messrs. Ginsburg, Peterseil and Weiner, or companies with which they were affiliated, were vendors to Lady Rose.

Herbert Kurtz was the vice president of Rockower Bros. Inc., whose wholly owned subsidiaries were operators of leased departments in Masters' stores.

As noted above, the Biblowitzes assumed control of Masters in 1963, controlled both Masters and Lady Rose prior to and at the time of the merger in 1967 and controlled Masters after the merger. (Stipulated facts, pre-trial order, p. 11).

Kalish, Rubinroit had prepared and distributed at the meeting a confidential memorandum to Masters' directors setting forth the principal aspects of a proposed plan of merger to be submitted to the board. This memorandum advised that Lady Rose would relinquish its 69,629 17/27 shares of Masters common stock and its $80,000 of subordinated debentures, that the proposed plan of merger had been drafted to qualify the carryforward loss of Masters as an offset against taxes on future earnings of the merged company; that the valuation of the constituent companies

for the purpose of the merger was $6,000,000 for Lady Rose and $777,490 for Masters, and showed a pro forma balance sheet of the merged company, setting forth financial information of the two companies from April 30, 1962 to August 31, 1966. It also showed that of Masters' six months loss of $794,815 for the period ended July 31, 1966, $561,367 was attributable to the closing of the Miami stores (Exh. 1).

Defendant Louis Biblowitz presented the proposed terms of merger to the board. Mr. Biblowitz told the board that:

(a) The earnings of Masters projected to January 31, 1967, would show, according to the opinion of the Secretary-Treasurer, a "break-even" or at best, a small profit.

(b) The after tax earnings of Lady Rose projected to January 31, 1967 were estimated to be $600,000.

(c) The company had a carryforward loss of about $3,378,849 which the accountants for the company advised might be applied (subject to a ruling by the Internal Revenue Service) against the future earnings of the merged companies. Assuming that the pattern of performance of Lady Rose continued in the projected amount of $600,000 annual earnings, then the aforesaid carryforward loss would enable all earnings of the merged company to be after tax earnings, to the full extent of said loss.

The board was advised:

"An important tax aspect of this plan is the availability of the carry-over loss without the reduction described in Sec. 382(b) because the stockholders of Masters, Inc. (the loss corporation) retain at least 20% of the stock of the acquiring corporation. Under the law, (Sec. 382(b)) a reduction in the carry-forward loss of 5% is required for each 1% of equity below 20% not retained by the stockholders of the loss corporation....(Example - if the loss corporation stockholders retain only 10% in the merged company, then only 50% of the loss carry-over is available)."

The minutes of Masters' Board of Directors meeting of October 31, 1966 recites that Kalish, Rubinroit & Co., the accountants for Masters and Lady Rose, advised the board on October 31, 1966 that in their opinion, but subject to a ruling by the Internal Revenue Service, Masters' tax loss carryforward of approximately $3,378,849 could be applied against the future earnings of the merged company and, assuming that the pattern of performance of Lady Rose continued in the projected amount of

$600,000 annual earnings, then the aforesaid carryforward loss would enable all earnings of the merged company to be after tax earnings, to the full extent of said loss. In January of 1967 the Internal Revenue Service rendered a ruling that the tax loss carryforward of Masters could be applied against future earnings of the merged company, if any. 13/

By treating the 1,750,000 shares of common stock of Masters to be issued to Lady Rose as equity and the 1,750 shares of Masters preferred stock (convertible into 1,750,000 shares of common stock in 1973) as non-equity, under the plan the Biblowitzes, as stockholders of Lady Rose, would receive less than 80% of the common stock of Masters and there would be no reduction in the carryforward loss of Masters. Inclusion of the 1,750,000 shares of common stock after conversion would give the Biblowitzes 89.95% of the equity and would reduce the carryforward loss by approximately 50%. The issuance of the preferred stock had the effect of giving the Biblowitzes approximately 90% of the equity without reducing the carryforward loss of Masters.

At the Board of Directors meetings of Masters I on October 31 and November 7, 1966, certain directors stated that $1,600,000 representing 50% of Masters' tax loss carryforward

should be added to the net worth figure of $1,600,000. (Stipulated facts, pre-trial order, pp. 4-5).

The others expressed their views, some differing initially with those of the Biblowitzes. Several of the directors stated that it appeared that the value of Masters was equal to or greater than that of Lady Rose and that the proposed issuance of 1,750,000 shares of common stock and 1,750 shares of preferred stock of Masters for all of the stock of Lady Rose should be reduced. These directors stated that to the net worth figure of some $1,600,000 for Masters, there should be added another $1,600,000 representing 50% of Masters' tax loss carryforward. Some of the directors stated that an opportunity should be had to ascertain whether any other company might be interested in purchasing Masters or merging with it. Louis Biblowitz advised the members of the Board of Directors that he had already made inquiries along these lines which had not proved fruitful. (Stipulated facts, pre-trial order, pp. 6-7).

The adjourned meeting of the Masters board was held on November 7, 1966 and was attended by all the directors except Louis.

Certain of the directors stated that less consideration than the number of shares proposed to be given by Masters in exchange for all the shares of Lady Rose should be issued and

again raised the question whether it would be to Masters' advantage to attempt to interest other companies in acquiring or merging with it. (Stipulated facts, pre-trial order, p. 7).

At this meeting, the terms of the merger proposal were amended as follows: the subordinated noted, except for the $80,000 held by Lady Rose which was to be retired (Exh. 1), were to remain outstanding with all of their terms in full force and effect and the mandatory conversion date of the proposed preferred stock was to be February 1, 1973 instead of February 1, 1972.

At this meeting, Kopelson, the treasurer and chief financial officer of Masters, was called upon to report Masters' posture and to give his opinion of the effects of the merger upon Masters. He reported that the net worth of the company following the disposal of the Florida stores was approximately $1,600,000 to $1,700,000. He stated that the cash paid by the purchaser of the Florida stores had been fully utilized by Masters to pay Florida creditors, the subordinated A and B debentures, for the acquisition of shares from Haizen, for obtaining a certificate of deposit of $100,000 in connection with the payment of creditors under the Plan of Arrangement and for the deposit of $50,000 in security incident to the renewal of the 48th Street store lease. Kopelson pointed out that in the

regular course of Masters' business, Masters, at this time of the year, borrowed substantial funds from banks. However, up to that time, it had not borrowed any such funds although he anticipated that it would be required to attempt to do so. Kopelson further reported that Masters was facing a difficult operating situation. He stated that from an operating viewpoint, it was essential for Masters to acquire a fifth location so that its advertising, general and administrative expenses could be spread over a greater volume than that afforded by the four locations Masters then owned. He also stated that Masters experienced great difficulty in effecting lease arrangements because of the competition for locations by its competitors and others possessing a better financial position than Masters. In his judgment, the merger plan would lift Masters to a far better financial stature, thereby enabling Masters to deal more effectively in securing a fifth location as well as in dealing with suppliers (Exh. 5).

Kopelson had pointed out to the Masters' directors that years were elapsing in which the tax loss carryforward was not being utilized because Masters was incapable of generating profits to offset against the carryforward and that if this continued, the tax loss carryforward would expire without being used. In the posture of Masters in October and November of 1966,

with no prospect of profits, Kopelson's conclusion was that Masters could not utilize the tax loss carryforward (Tr. 897). The board members assigned no value to Masters' tax loss carryforward (Tr. 54, 101, 132, 360).

Following Kopelson's report, the Masters' directors further discussed the proposed merger, propounded questions to counsel and to the accountants, and then voted to merge with Lady Rose. Kurtz, who testified that he believed that the merger would be good for Masters because Masters needed money and management, (Tr. 2044), voted against the proposal stating:

> "I am in favor of the merger. My disagreement is only with the values that were reached as a basis for the merger. I think the merger will be good for the Company." (Exh. 5).

Directors Peterseil, Abramson and Weiner testified they voted in favor of the merger because, without the merger, they believed their investment and that of the other Masters' shareholders would be lost (Tr. 47, 48, 111, 112, 149).

Although Kurtz, who was executive vice president of Rockower Brothers, the men's wear concessionaire in Masters' stores, voted against the merger, BAC Discount, Inc., the

company in which the Rockower Brothers were the sole stockholders, voted all of its shares in favor of the proposed merger at the stockholders' meeting.

Masters I did not have an independent appraisal made of either its equity value or that of Lady Rose.

The proxy statement and accompanying letter sent to stockholders stated that the directors believed the terms of the merger were "fair and equitable", "in the best interests of the stockholders of Masters, Inc." The statement did not disclose that the directors' vote in favor of the merger was not unanimous nor did the statement separate out the losses of the discontinued operations in Florida in its report on Masters' financial condition.

The proxy statement did disclose that Kalish, Rubinroit was the independent certified public accountant for Masters (Exh. 2, p. FS-1) and for Lady Rose (Exh. 2, p. FS-10). It also disclosed that the Biblowitzes controlled Masters and Lady Rose.

The proxy statement was prepared by Feldshuh & Frank, representing Masters, and Ward of Sassower's office, representing Lady Rose.

The terms of the merger were as follows: Masters issued to the Lady Rose stockholders 1,750,000 shares of its

common capital stock and 1,750 shares of a new 5% non-cumulative preferred stock, par value $1,000 which preferred stock must be converted on February 1, 1973 into 1,750,000 shares of common stock. Upon such conversion, Lady Rose would receive 3,500,000 shares of the common stock of Masters. Masters, prior to the merger, had 460,732 shares of common stock issued and outstanding in the hands of the public. Lady Rose owned, via voting trust certificates, 69,629-1/27ths shares of Masters which were cancelled under the terms of the merger. Lady Rose would receive after conversion 3,500,000 shares of Masters common stock or 89.95% and the public stockholders of Masters (including directors other than the Biblowitzes) retained 391,102 shares of Masters common stock or 10.05% of the newly issued and outstanding stock. Lady Rose distributed all the Masters shares received by it to the Biblowitzes

The preferred stock in Masters received by the Biblowitzes differed from the common stock in that it was entitled to non-cumulative dividends at the rate of 5% per annum before dividends could be paid to the holders of the common stock. The stock was non-voting and non-redeemable.

The plan contemplated a minimum 20% equity in the $1 par value common stock of the minority shareholders until January 31, 1973.

The plan as drafted qualified for the carryforward loss of Masters of approximately $3,378,849 as a net operating loss deduction against the future earnings of the merged companies, if any. (Stipulated facts, pre-trial order, pp. 1-2).

On January 26, 1967 the stockholders of Masters approved the plan of merger by a vote of 370,315 18/27th shares in favor and 63,389 9/27ths shares against; plaintiffs voted against the plan. (Stipulated facts, pre-trial order, p. 8).

The testimony of the various expert witnesses as to how the value of Masters and Lady Rose shares should have been appraised was, as might be anticipated, in sharp conflict.

According to Leonard Marx, a securities analyst and one of plaintiffs' experts, the fair market value of Masters was $3,000,000 as of November 15, 1966. According to Marx's report,

> ". . .[T]he elimination of the Miami units, change in management [after the merger], renegotiation of leased department leases, and strong financial condition of Masters after the Miami sale and cash received from Zayres, indicates at least a breakeven operation currently [as of November, 1966], a projection of at least $400,000 pre-tax once these changes took place." (Exh. 153, p. 13).

According to Mr. Marx, the pertinent figures in appraising Masters' value were as follows:

Revenues	$18,000,000
Estimated pre-tax net	400,000
Working capital	1,800,000
Long-term debt	400,000
Net Property	400,000
Stockholders Equity	1,700,000
Value of tax loss carryforward	800,000 to 1,300,000
Adjusted Equity	2,500,000 to 3,000,000
Growth rate	0%
Valuation	$3,000,000

(Exh. 153, p. 22).

The evaluation of the tax loss carryforward was based on the assumption that if would be fully utilized by the merged company and that the tax rate of the new company would be between 35 and 48 per cent. (The $800,000 figure reflects a tax rate of 35%).

The final line — Masters' valuation -- was based on ". . .what the company was worth to other people, based upon a number of transactions which we studied. . . ." (Testimony of Leonard Marx, Tr., Feb. 7, 1973, p. 18).[14/] Marx, in appraising the acquisition value of Masters I, compared the above figures with those of publicly traded discount department store chains and the acquisition value when the company was acquired by another chain. (Exh. 153, p. 14).

According to Mr. Marx, the pertinent figures in appraising the valuation of Lady Rose as of November, 1966 were as follows:

Revenues	$13,000,000
Estimated pre-tax net	700,000
Working capital	1,800,000
Long term debt	0
Net property	400,000
Stockholders equity	2,300,000
Adjusted Equity	2,300,000

Growth rate 17%

Valuation $3,350,000

(Exh. 153, p. 22).

In determining valuation, Mr. Marx compared data pertinent to other, similar lessees. (See Exh. 153, p. 5). Since "Lady Rose. . . [was] the smallest and least geographically diversified of the companies. . ." he had examined and the other companies which were publicly owned had valuations ranging from six to eleven times their earnings, Lady Rose should be valued at seven times its earnings. The valuation would accordingly be $3,200,000 based on fiscal 1966 earnings and $3,700,000 based on estimated fiscal 1967 earnings.

However, Marx decided that the valuation of $3,700,000 should be reduced:

> "In July 1966 Zayre purchased the 3 Miami stores of Masters and terminated Lady Rose's leased departments in these 3 units. That kind of risk explains why the stock market was reluctant to place a normal price-earnings multiple on this type of operation. On termination of its Florida leases, Lady Rose did not receive a premium over its book cost of its inventory and fixtures. Since Lady Rose did not have an active expansion program where it had executed

leases for new locations to replace those units, I believe this volume should be deleted in estimating Lady Rose's fiscal 1967 (and future years) volume, profits, and growth potential." (Exh. 153, p. 9)

After making adjustments for the loss of the Florida operations and also for anticipated increases in the rent Lady Rose would have had to pay Masters I but for the merger, Marx arrived at a valuation of $3,350,000 for Lady Rose.

Defendants' expert, Martin J. Whitman, a certified chartered financial analyst, reported, on the other hand, that the terms of the merger were ". . .fair and equitable to the Masters' stockholders. Further, the merger was highly beneficial to Masters." (Exh. AZ, p. 1).

According to Whitman, among the factors he considered were the following: ". . .the financial and business histories of both corporations; their financial positions and management situations; the potential of the merged enterprise and an evaluation of the benefits and encumbrances, whether tangible or intangible, which each would bring to the merged enterprise."

Mr. Whitman reported that

". . .a fair and reasonable value for the Lady Rose equity would be in a range between $5-$6 million based on a price earnings ratio of approximately 8 to 10 times conservatively estimated earning power at the time of approximately $600,000 per annum." (Exh. AZ, p. 2).

According to Whitman's analysis, the earnings estimate of $600,000 for the fiscal year ending in February 1967 was reasonable. In his opinion, the estimate took into account the loss of the Florida concessions since Lady Rose had already reported net profits of $331,491 for the six months ending August 31, 1966 and, based on past seasonal patterns, might have anticipated earnings of $898,000 for the year, without allowing for the discontinued operations, rather than $600,000. (Exh. AZ, pp. 3-4).

Whitman testified that the eight to ten times multiple was based on the index of "retail" companies filing annual reports with the Securities and Exchange Commission as of December, 1966. Of the companies within this index, the average multiple was 9.1. (Tr. 1885).

Whitman further reported that the board of directors' evaluation of Masters was reasonable in view of its poor credit standing, its "uncertain" management situation, and its losses. (Exh. AZ, p. 7).

According to Whitman:

> "Further compounding the difficulties to obtain [sic] earning power for Metropolitan Masters was the sale in July 1966 of Masters' Florida operations. The Florida operations had absorbed a portion of Masters' central overhead which included expense items such as buying, bookkeeping and home office administration." (Exh. AZ, p. 8)

Whitman noted that few of the purchasers of Masters' subordinated loan took advantage of their right to purchase Masters' stock at $1.25 per share before December 27, 1966. (Exh. AZ, p.9).

Finally, in Whitman's opinion, the value of Masters' tax loss carryforward to Lady Rose as of the time of the merger was slight since 1) Lady Rose would also have to assume the obligations of Masters I, including the obligations to the creditors' committee, 2) it was uncertain whether a combined Masters — Lady Rose operation would enjoy sufficient profits to fully utilize the carryforward, 3) Masters' tax returns had only been reviewed through April 30, 1963 and, consequently, the size of the carryforward could only be estimated and 4) under Section 269

of the Internal Revenue Code,[15] the Internal Revenue Service might contest use of the carryforward by the merged company.

Finally, Whitman reported that it could be anticipated that Lady Rose would enter a higher tax bracket after the merger since it could no longer file unconsolidated tax returns. (Defendants' Exhibit AZ, p. 12). According to Whitman, this tax disadvantage would help offset any advantage to be obtained from Masters' carryforward.

A judgment will be entered for defendants in accordance with this opinion.

Dated: New York, New York

January 22, 1974

CONSTANCE BAKER MOTLEY
U. S. D. J.

FOOTNOTES

1. See pp. 48-49, infra.

2. Rule 10b-5, based on Section 10(b) of the Securities Exchange Act of 1934, provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (1) to employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

3. See pp. 17, infra.

FOOTNOTES

4. Masters' history of financial difficulties is set forth in the proxy statement. See pp. 5 (discussion of petition for arrangement, filed in 1963), 9 (discussion of Masters' tax loss carryforward), FS-2-3 (Masters, Inc. statements of income). Even if, as plaintiffs claim, the income statement should have explained that some of Masters' prior losses were attributable to discontinued operations, the income statement correctly revealed that Masters had had a history of substantial losses.

5. See pp. 16-18, infra.

6. See p. 37, infra.

7. See pp. 16-18, supra.

8. See pp. 56-57, infra.

9. The terms of the Plan are set forth in Proxy Statement, Plaintiffs' Exhibit 2.

10. These four stores are hereinafter referred to as "the metropolitan stores."

FOOTNOTES

11. Lady Rose in July of 1966 sold its inventory and fixtures in Masters' three Florida stores, in which it operated concessions, to Zayre Corp. and its subsidiaries. The net income of Lady Rose in the discontinued Masters' stores located in Florida was reported as follows:

	Before Tax	After Tax
2/29/64	$11,676.89	$8, 212.11
2/28/65	35,076.77	27, 379.33
2/28/66	91,282.32	63,621.60
6 mos. ending 8/31/66	69.698.87	44,618.87

The net income of other discontinued operations of Lady Rose was reported as follows:

	Before Tax	After Tax
2/29/64	$20,754.09	$13,485.92
2/28/65	11,244.29	9,527.85
2/28/66	28,120.68	19,970.77
8/31/66	21,235.70	14,145.70

FOOTNOTES

12. Lady Rose, as a concessionaire in Masters' stores, was technically a tenant of Masters.

13. Special tax counsel for Masters were orally advised pursuant to request for a ruling that a formal letter would be issued by the office of the Commissioner of Internal Revenue, which was received in February 1967, assuring the favorable tax treatment upon which the proposed merger had been predicated which included a ruling to the effect that the surviving corporation as a result of the merger will be "entitled to carry-over as an offset what otherwise would be taxable income in future years, the full amount of the operating losses incurred by the present Masters, Inc. during the past five years."

The carryforward loss of Masters was fully utilized by the merged company in fiscal years 1968, 1969 and the first month of 1970. Masters II saved a total of $1,905,000 in taxes for those years.

14. The transcript of Mr. Marx's testimony is paginated separately.

FOOTNOTES

15. Section 269 provides for the disallowance of tax deductions, credits and other allowances obtained as the result of a corporate acquisition the principal purpose of which is to obtain a tax benefit.

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

ANTOINETTE M. BRAGALINE, ET AL, Plaintiffs,

-against-

LOUIS BIBLOWITZ, ET AL, Defendants.

67 Civil 4988(CBM)

JUDGMENT

This action involves the merger of a department store, Masters, Inc., (Masters I) with Lady Rose Stores, Inc., (Lady Rose) in 1966, and the said action having come on to be heard before the Honorable Constance Baker Motley, United States District Judge, and the Court thereafter on January 23, 1974, having handed down its opinion, findings of fact and conclusions of law in favor of the defendants, it is,

ORDERED, ADJUDGED AND DECREED, that defendants, LOUIS BIBLOWITZ, ET AL., have judgment against the plaintiffs, ANTOINETTE M. BRAGALINE, ET AL., dismissing the complaint.

Dated: New York, N. Y.
January 23, 1974

Raymond F. Burghardt
Clerk

Copy Rec'd May 8 1974
Clerk Schmidt & Schmitz
Attys for Masters Inc

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